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College Funding: Planning Ahead for Financial Security

In recent years, the cost of higher education has risen well ahead of inflation. At some private colleges and universities, the net cost for one year's full-time education, including tuition, fees, and room and board, tops $40,000 (*Trends in College Pricing—2012*, The College Board). At these prices, the final cost of a bachelor's degree from a private institution could exceed $160,000. In addition, with many professions requiring graduate degrees, it quickly becomes apparent that very few families may be able to cover education expenses with their current incomes. With only one child, the costs can be prohibitive; for families with three or more children, college and graduate school costs could easily be hundreds of thousands of dollars.

How can parents and grandparents build a fund for college? They need to look ahead and prepare a "blueprint" as early as possible, and there are a number of ways to do this. The best method will depend on the age of the child, the family's resources and cash needs, and a number of other considerations.

No matter what the age of the child, there are legal techniques for placing money and property in a child's name. Since it is generally inadvisable for minors to own property or have large bank accounts in their own names, gifts to minor children are usually made either to a **custodian** or to a **trust**.

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Select Trustees with Care

If you are thinking about establishing a **trust**, you need to select a **trustee—**someone who is charged with administering the trust according to your wishes. Perhaps you are considering naming a family member, or maybe you are wondering whether it would be wiser to designate your attorney or another trusted professional. Choosing a trustee is an important decision that requires great care and an analysis of your unique circumstances.

A trustee's role is to comply with the terms of the trust and fulfill its objectives. In selecting a trustee, you may want to weigh many personal, family, asset management, and business concerns. For instance, an important consideration is the *size* and *complexity* of the trust. Corporate and professional trustees often possess the accounting, tax planning,

and money management experience necessary to administer large, complicated trusts. On the other hand, a small trust may not warrant professional management.

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Taking Measure of Inflation

Prices tend to rise over time—sometimes steadily and sometimes abruptly. In the years ahead, **inflation** will most likely decrease the purchasing power of your money, which means that during retirement, your dollars will buy less than they do today.

It is easy to misinterpret inflation as the rise in price of *individual* goods and services. However, inflation is the increase in the average price level of *all* goods and services. For example, the price you pay for oranges may rise during the winter due to unseasonably cold temperatures in Florida. On the other hand, the average price of other items in your local supermarket, like peanut butter and paper towels, may remain relatively level. So, the increase in the price of oranges is not a result of inflation but, rather, a function of **supply** and **demand**.

What Causes Inflation?

Inflation can result when either: 1) the total of all goods and services demanded exceeds production; or 2) there is a decrease in the amount of all goods and services supplied by producers. Note how, in the above example, the supply and demand for the oranges had no effect on inflation. However, changes in supply and demand on a broader scale can result in inflation.

Consider the following economic scenario: Suppose business is booming, unemployment is low, and the average worker's wages are increasing. As a result, consumers have more disposable income available and may therefore, be able to purchase more goods and services. Average prices tend to rise under these circumstances due to the increase in *demand* for all goods and services.

In another scenario, suppose the economy is suffering. As unemployment rises and wages remain stagnant, consumers may be unable to purchase additional goods and services. Production may then slow down with prices going up to minimize the losses. In this cycle, average prices tend to rise due to a decrease in the *supply* of all goods and services.

It is important to keep in mind that individual consumers are not the only market participants that can affect the economy. Businesses, government agencies, and foreign markets also spend billions of dollars on U.S. goods and services. Their spending, or lack thereof, can equally influence increases or decreases in supply and demand that, in turn, can result in inflation.

Inflation and Economic Policy Decisions

To a certain extent, *some* inflation may be a sign of a healthy economy. In fact, one of the economic policy goals of the U.S. government is to maintain an inflation rate ranging from 0% to 3% per year. On the other hand, too much inflation or no inflation at all can be a sign of troubling economic times. So, one of the greatest challenges facing policymakers is to make decisions that will create desired inflation results.

There are two Federal economic policies used in an attempt to control the economy. **Fiscal policy**, which falls under the auspices of Congress, uses taxation and spending to reach full employment, stabilize prices, and boost economic growth. In contrast, **monetary policy**, which is controlled by the Federal Reserve Bank (the Fed), manipulates the money supply and short-term interest rates in an attempt to spur growth or control inflation.

Congress and especially the Fed look at the **Consumer Price Index (CPI)** when making policy decisions. The CPI is considered by many to be one of the best measurements of inflation. The CPI gauges the average change in prices paid by urban consumers for a fixed market basket of goods and services over a period of time. The CPI represents all goods and services purchased by urban consumers. Each month, the CPI is calculated, and constant fluctuations in the CPI will ultimately result in Congress or the Fed taking appropriate measures to regain control of inflation. However, in the short term, the Fed holds the ability to react quickly. Congress requires political debate and the passage of legislation before fiscal decisions can be carried out.

On a Personal Level

In addition to creating higher costs for goods and services, inflation creates depreciation in currency values. So, as prices increase, the purchasing power of your income (dollar for dollar), decreases. During sound economic times, price increases will usually be accompanied by wage increases that are equal to, or greater than, inflation. However, during economic downturns when wages remain level, the cost of living increases as your purchasing power diminishes.

Regardless of what state the economy is in, one of your greatest long-term financial challenges may be planning for your retirement savings to outpace inflation. Therefore, it is always important to consider inflation, not only as you save, but also as you make purchasing decisions. $

Setting a Price for Buying or Selling a Business

In the overall U.S. business landscape, mergers, takeovers, and buyouts are occurring at a steady rate. If you were to place your business on the market would you know what it is worth? Setting the price is often the most important aspect of the transaction.

Many business owners tend to base their companies' worth on "sweat equity." However, that does not have much to do with market value. To learn the true value of your business, you need a more scientific approach, starting with a valuation method. The most common methods are the following:

1. Comparables. Value is determined by the ratio of sales price/earnings of recently sold companies (similar in nature to your own) multiplied either by your earnings, or by your revenues.

2. Discounted cash flow. Value is determined by your company's projected cash flows discounted back to the present at a rate that incorporates risk.

Other factors also come into play, such as company size, industry, customer base, growth potential, competitive positioning, product mix, technological capabilities, and management talent. It is also important to realize that a company's value will vary with different buyers. Some buyers identify synergies and are willing to pay a premium; others will try to undercut naïve sellers who do not know their own company's value.

So, how do you become more knowledgeable about your company's worth? Retain the services of a professional valuator—a qualified individual who is objective, understands the buyers in your market, and has years of appraisal experience.

The Important Role of Taxes

In all the excitement of buying or selling a business, it may be hard to focus on taxes, but they affect the real price of the business. So when trying to assess the *real* price of your business, look at the components that make up the real price, including:

- The type and quality of the consideration
- The timing of the payments
- The tax effect of the transaction.

These components overlap, with the type and quality of the consideration and timing of payments greatly impacting the overall tax effect of the transaction. To determine the real price of your business, you will need to compare the tax effect of various reporting alternatives and a range of prices. Intangible assets, such as goodwill and intellectual property rights, both inside and outside the business (if any) will need to be identified. You should also consider other interrelated agreements, such as employment, consulting, or noncompete. In other words, hold off on negotiating until you know what you really have and what your possible options are.

Taxable or Not?

The majority of businesses are sold in taxable transactions. Nontaxable transactions include mergers and situations where the seller takes as consideration buyer stock or qualifying property in an exchange.

Although the general tax-planning rule is to avoid or postpone tax, there are some advantages of a taxable sale, such as:

- When the seller gets cash, concerns about the quality of buyer stock or the limitations inherent in selling buyer stock are nonexistent.
- The buyer does not have to contend with the seller as a shareholder and can get a stepped-up basis in the assets.
- The parties do not have to worry about the technical requirements of a tax-free or tax-deferred transaction.

A taxable sale can be structured as either an asset sale or a stock sale. In general, the seller wants a stock sale and the buyer wants an asset sale. See the chart on page 7 for a comparison of these two alternatives.

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How Much Can You Earn and Still Receive Social Security?

Retirees are often ready, willing, and able to start new careers that may earn them significant incomes during their years of "leisure." However, some individuals may feel that it is not worthwhile to work for wages, only to have to "give up" some of those earnings in the form of higher income taxes. As frustrating as that may sound, it is important to understand the fundamentals of Social Security income and taxation so you can make your retirement years more "golden" and less "taxing."

Income Limits: Paying to Work?

The first factor to consider is the Social Security "give-back." If you are age 62 or older, but still under the **full retirement age** (65–67 depending on your birth year), and receiving reduced Social Security benefits, you must "give back" $1 for every $2 earned above $15,120 in 2013. If you reach full retirement age in 2013, your benefits are reduced by $1 for each $3 earned over $40,080 in months prior to your full retirement age. When you reach your full retirement age, there is no limit on your earnings, and Social Security benefits are not reduced.

How Much Is Taxable?

A second factor affecting your Social Security income is the potential taxation of your monthly benefit. If you are working and also receiving a check from the Social Security Administration (SSA) each month, you must first determine how much, if any, of your benefit is included in your **gross taxable income**. The first step in estimating this amount is to add half of your Social Security benefits to all your other income, including any tax-exempt interest.

This total is then compared to a first-tier threshold of $25,000 for a single taxpayer or a married taxpayer who is filing separately and lived apart from his or her spouse for the entire year, or $32,000 for a married taxpayer filing jointly. For a married taxpayer filing separately, who lived with his or her spouse for any period during the year, the first-tier threshold is $0.

For illustrative purposes, suppose your total applicable earnings are $27,000, and you are married and filing jointly. Since the total does not exceed the applicable threshold amount of $32,000, then *no* portion of your Social Security benefit is taxable. However, if the total exceeds the applicable threshold amount, further calculation is needed to determine the amount of your benefit that is taxable. For more information, refer to IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*, visit the Social Security website at www.ssa.gov, or consult your qualified tax professional.

Performing these calculations is no simple task. So, it is important to understand the potential tax consequences when thinking about receiving Social Security while still working, and plan accordingly. As with all tax planning matters, be sure to consult a qualified tax professional to help ensure that your planning decisions are consistent with your overall financial goals. $

Options for Your Charitable Donations

It may be better to give than to receive, but it may be even better to give and see your generosity rewarded. Charitable giving can play a valuable role in your financial and tax strategies. A well-planned gift to charity could provide an income tax deduction and a reduction of estate taxes. Your donation could also help you maintain financial security, exercise control over assets both during your lifetime and after death, as well as provide for your heirs in the manner you choose.

In order to accomplish all of these objectives, you need to develop a plan tailored to your individual circumstances. The following strategies can be used to create a giving plan that is both beneficial and appropriate for you.

When planned properly, **gifts of appreciated property** to charity may allow you to avoid the capital gains tax you would have owed upon the sale of the asset and receive an income tax deduction, usually worth the **fair market value (FMV)** of the property. Also, by removing that asset from your estate, you may reduce your potential estate tax burden.

If you wish to make a gift of property to a charity but also retain some control over it, a **Charitable Remainder Trust (CRT)** may be an appropriate vehicle. A CRT is most effective when funded by an appreciating asset, such as stock in a family-owned business or real estate. After transferring the property to the trust, no income tax is imposed on income

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College Funding: Planning Ahead for Financial Security

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The Custodial Account

While some of the tax advantages of a custodial arrangement have been affected by tax law changes, the technique is still worth investigating. It is the simplest method to give money or property to a child, involving very little paperwork, hassle, and legal fees.

All states have adopted either the **Uniform Gift to Minors Act (UGMA)**, which authorizes a custodial arrangement for cash, bank accounts, and other savings vehicles, or the **Uniform Transfer to Minors Act (UTMA)**, which allows the custodian to hold real estate and other property, including limited partnership interests. The laws of the state in which the minor lives will govern the account.

In many states, money or property held in custody must be transferred to the child at either age 18 or 21, depending on state law. Some states allow the custodian to designate the age at which the child may access the account, even beyond the age of majority. When the child has attained access to the custodial account, he or she may use the funds for whatever purpose he or she chooses, even if it's not to pay for tuition.

Trust Benefits

Establishing a trust for a child may be more cumbersome and expensive than the custodial arrangement, but it may be desirable in some situations. One important reason to transfer property to a trust for the benefit of a child is to prevent him or her from "wasting" the funds. The money in the trust, whether it's principal or income, must be used solely for the purpose for which the creator of the trust intended—the child's education.

The creator of the trust may wish to use the Federal **annual gift tax exclusion** that allows individuals to give $14,000 (in 2013) each year to as many donees as they wish (or $28,000 if a spouse joins in making the gift). This exclusion only applies if the trust is structured to create a "present interest" in the child beneficiary. The present interest requirement may be used in a number of ways, some prescribed by the Internal Revenue Code (IRC), and some by case law.

Discretionary trusts can also be used. The trustee may accumulate income to take advantage of the trust's 15% tax bracket or to distribute it to the beneficiary in a tax bracket that is lower than that of the trust.

Prior to making gifts or establishing trusts, the effects of either method on long-term financial goals and college savings programs need to be thoroughly assessed. Providing the best education for your child, while preserving the finances of the family, is integral to any decision. $

Options for Your Charitable Donations

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remaining in the trust, and you may take a current income tax deduction based on the future value when it is transferred to the charity. By removing the remaining value of the asset from your estate, you may reduce your potential estate tax liability. In short, you obtain the tax benefits of giving while postponing receipt of the gift by the charity.

If you wish to give to a charity without giving the asset away permanently, consider a **Charitable Lead Trust (CLT)**. Through a CLT, you essentially give the charity the use of an asset and the right to any income generated for a predetermined time. After the specified time has lapsed, the asset can revert to you or be given to whomever you choose. Appropriate assets might be income-producing stocks and bonds, your rare book collection, or a painting that you transfer to a museum for a certain length of time. You may receive a current income tax deduction for the value given to charity; however, the trust pays income tax on its income. If a CLT is created upon your death, estate tax liability may be reduced.

Early tax planning can help you make the most of your charitable giving opportunities and allow you to take advantage of additional benefits. Be sure to consult your team of qualified tax, legal, and financial professionals for specific guidance. $

What You Should Know about Whole Life Insurance

When faced with the wide range of life insurance coverage available, you may wonder what type really fits your needs *now* and what coverage you should have in place for the *future.* A good first step is to understand basic **whole life insurance** coverage.

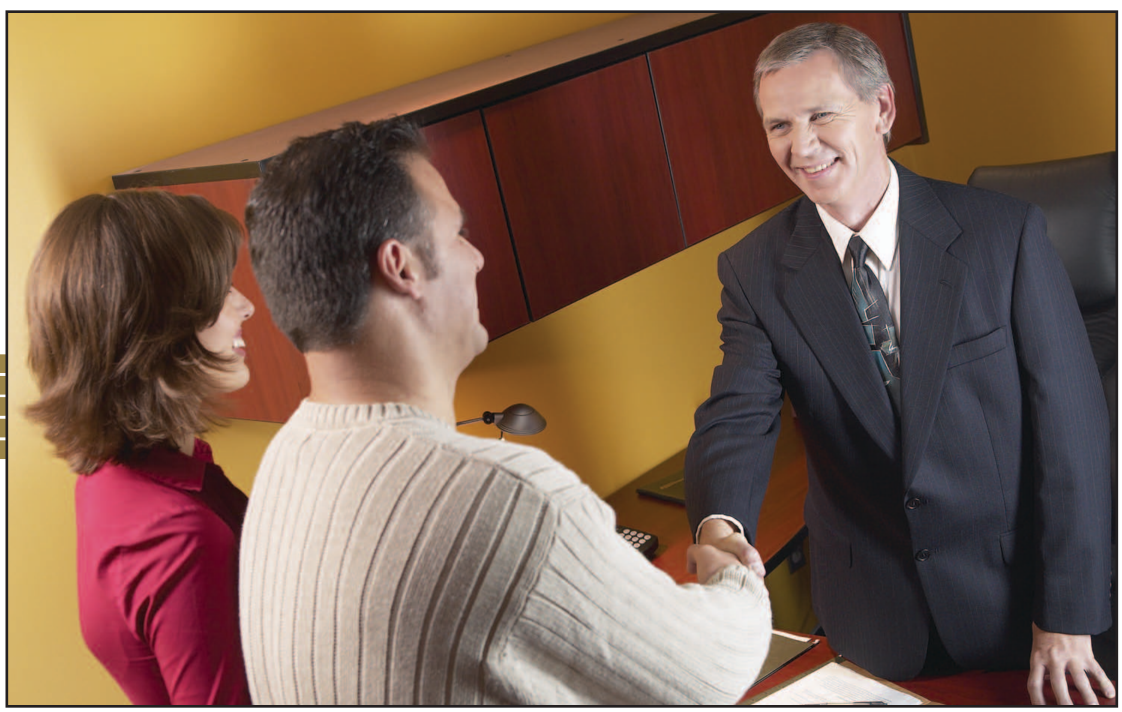
Whole life insurance provides a benefit in the event of death, and it also has the potential for *tax-deferred* **cash value** accumulation. Premium payments first pay the cost of pure insurance coverage, including the expenses and mortality factors of the insurance company. The company then invests the remaining premium dollars to build the cash value of the policy.

A second feature of whole life insurance is the predictability of expense. As long as the insured continues to pay premiums according to the contract, premium amounts will not change and will continue until the policy matures, which is when the cash value of the policy equals the **face amount** of the policy. The point at which premium payments cease is clearly stated in the policy (typically age 65, 75, 85, or 95). The length of the payment period will, of course, affect the dollar amount of the premium payments.

The **guarantee** of insurability is a third feature of whole life insurance policies. Once the policy is issued and as long as premium payment responsibilities are met, the insured is guaranteed coverage for life in accordance with the terms of the policy. Evidence of insurability is not required after the policy is issued, as long as the original policy remains in force.

The final feature to consider is the ability to borrow against the cash value of a whole life insurance policy. Funds may be borrowed against the cash value of the policy at any time, depending on the policy. It is important to note that access to cash values through borrowing or partial surrenders can reduce the policy's cash value and death benefit, can increase the chance that the policy will lapse, and may result in a tax liability if the policy is terminated before the death of the insured. Loan approval must come from the insurer, but it is fairly routine. No repayment schedule is set beyond the regular payment of interest on the loan, with outstanding loan balances deducted from the death benefit in the event of the insured's death.

Once you have considered the life insurance options available, be sure to evaluate them in relation to your personal needs. If you seek an instant "estate" to provide for loved ones, or wish to cover certain financial obligations in the event of your death, then a whole life policy may be a viable option for you. Whole life insurance policies are subject to fees and charges. Guarantees are based on the claims paying ability of the issuer. $



Select Trustees with Care

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Duration is another significant concern. A trustee's responsibilities often span one or more generations. **Corporate fiduciaries** may have the advantage of perpetual life (although the individuals administering the trust may change over the years). This longevity may also allow them to more easily fulfill the recordkeeping and reporting requirements of the supervising court, as well as Federal and state governments. If you have decided to appoint only *individual* trustees, you may want to consider designating **co-trustees** or **successor trustees** to address longevity concerns.

Advantages of Professional Trustees

Corporate trustees have other advantages, as well. For instance, they may be more impartial when considering beneficiaries' needs than family members, who may face conflicts of interest. Also, corporate and professional trustees are held to a higher standard of professional conduct than non-professionals. Of course, professional service comes with a price. Many grantors of small trusts choose non-professional trustees to avoid high corporate fees.

Benefits of Family Members

When a personal touch is needed, family members or other non-professionals may offer special advantages as trustees. They generally have the sensitivity and flexibility required to support the special needs of a beneficiary. A family member or business associate may also be the preferred choice if you are leaving a business in trust, as corporate trustees generally do not run businesses.

Best of Both Worlds

Often, a *combination* of professional and non-professional trustees may work best. Corporate or professional trustees provide trust management expertise, while family members or other non-professionals respond to the changing needs and circumstances of beneficiaries.

Trusts are complex, varying by type and purpose, and are most likely to fulfill their objectives when responsibly administered. A trustee who is uninformed could mismanage a trust or take actions that could have serious tax consequences. A qualified legal professional can help you make the most appropriate choice for your particular situation. $

Setting a Price for Buying or Selling a Business

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Asset vs. Stock Sale

Asset Sale	Stock Sale
Seller: • Potential double taxation resulting in less net, after-tax proceeds. • Potential ordinary income, recapture, or higher tax rates on some assets. • Business can generally sell without minority shareholder consent.	**Sellers:** • One level of taxation. • Capital gain treatment. • Minority shareholders may not want to sell.

Timing of Payments

Sales are often structured as installment sales whereby the payments are extended over a number of years due to the buyer's lack of sufficient funds on hand. Installment sales are also useful since many small businesses are sold with an "earn-out" provision, in which the buyer pays a contingent amount over a number of years, based on the company's performance. Use of the installment method for tax purposes is advantageous for the buyer as it helps match the recognition of gain to when cash is actually received.

If you are considering a change, be sure to consult your tax professional to help determine the true value of your business, and your attorney to review the sale documents for accounting and tax considerations. $

The Importance of Advance Directives

Traditionally, estate planning has focused on minimizing estate taxes and directing the disposition of your assets after death. Today, managing your financial well-being often includes the potential need for long-term health care. If you were to sustain a debilitating illness, or become mentally incapacitated, which can occur gradually due to a progressive medical condition, or suddenly, from an unexpected accident, who would make your important legal, financial, and health care decisions, and on what authority?

Fortunately, **advance directives**—legal instructions that express your wishes regarding financial and health care decisions in the event that you become incapacitated—can provide much-needed direction under such circumstances.

Legal and Financial Decisions

A **durable power of attorney** grants authority to a designated person to make legal and financial decisions on your behalf, in the event of your incapacity. The powers granted can be broad or limited in scope. Your designated power of attorney can assist you with your personal finances, insurance policies, government benefits, estate plans, retirement plans, and business interests.

Health Care Decisions

Prior to becoming incapable of making important life decisions, a **living will** generally allows you to state your preferences regarding the giving or withholding of life-sustaining medical treatment. Although future changes to the law concerning this matter may occur, in most states, you must have a "terminal condition," be in a "persistent vegetative state," or be "permanently unconscious" before life-support can be withdrawn. The definition of these terms and the medical conditions covered may vary from state to state.

A **health care proxy** allows you to appoint an agent to make health care decisions on your behalf in the event of physical or mental incapacity. These medical decisions are not limited to those regarding artificial life-support.

Advance directives by durable power of attorney, living will, or health care proxy are usually inexpensive and easy to implement. They are essential estate planning tools for all individuals, regardless of age. Without such documents, court intervention, which can involve a great deal of time, expense, and stress for family members, may be necessary.

To learn more about state-specific advance directives, visit Caring Connections, a program of the National Hospice and Palliative Care Organization, at www.caringinfo.org. As with all estate planning concerns, be sure to consult your team of professional advisors to fully understand the impact of advance directives. $